

RAND Research Brief

Does Competitive Sourcing Pay Off? The DoD Experience

In recent years, the Department of Defense (DoD) has placed increasing faith in private-sector business practices as tools to save money and make its operations more efficient and effective. One particular business practice on which the Pentagon has pinned high hopes is competitive sourcing. By inviting private businesses to compete against in-house DoD workforces to provide commercial-type services, Pentagon planners expect to reduce overhead budgets, streamline operations, and shed personnel.

The Pentagon projects huge savings from such a competitive shift. During fiscal years 1997 through 2005 it expects to save \$9 billion by putting tasks involving some 200,000 positions out to bid. The bulk of those savings would come from reducing personnel, as competitors bid to perform the same work with fewer or less-expensive employees.

However, critics have begun to question whether competitive sourcing will produce the savings that the Pentagon expects. They suggest that competitions may involve fewer positions, take longer to complete, or be cancelled at higher rates than the Pentagon has planned. And the savings may fall short of anticipated levels or not last over many years.

A recent RAND study, *Personnel Savings in Competitively Sourced DoD Activities: Are They Real? Will They Last?* examined these questions in light of the DoD's limited recent experience with competitive sourcing. The study, done under the auspices of RAND's National Defense Research Institute, looked at personnel costs associated with several tasks that the DoD put up for competitive bid between 1989 and 1996. It compared the projected costs of providing services, as estimated by competitive bidders, with the actual costs of providing those or similar services. The study also looked at how the bidders planned to pro-

vide those services, i.e., the methods they chose to perform tasks at the lowest cost.

The study found that most bidders accurately projected the annual personnel cost savings from competitive bidding. Competitors expected that they could provide as good or better services with personnel costs that were 30 percent to 60 percent lower than pre-competition levels. Winning bidders obtained most of these savings by using fewer people, and they have been able to maintain those lower personnel costs over time. However, without significant managerial and organizational changes, the Pentagon will have a difficult time applying lessons it has learned in these initial competitive sourcing experiences to large segments of its uniformed and civilian workforce.

COMPETITIVE SOURCING VERSUS OUTSOURCING

The Pentagon has come under growing pressure from Congress and the general public to manage resources more effectively and reduce overhead. Today, some 60 percent of the DoD's annual obligation authority is spent on so-called support infrastructure—activities and facilities that are not directly part of DoD's core mission but that help accomplish that mission—with half that portion going toward personnel expenses.

As defense budgets became increasingly squeezed in the 1990s, DoD focused on these infrastructure expenses as a potential source of big savings, and it tapped competitive sourcing as a means to capture those savings. *Competitive sourcing* is a general term describing a process through which Pentagon managers consider proposals from both DoD employees, uniformed or civilian, and private businesses to determine who can provide a given level of service at the lowest cost. Competitive sourcing

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differs from another cost-savings tool that is popular with business—*outsourcing*—in a fundamental way: It allows internal *and* external suppliers to compete to provide services, whereas outsourcing looks only to external suppliers in search of less-costly services. Office of Management and Budget Circular A-76 spells out the rules and procedures government managers must follow when they look to obtain services from competing sources.

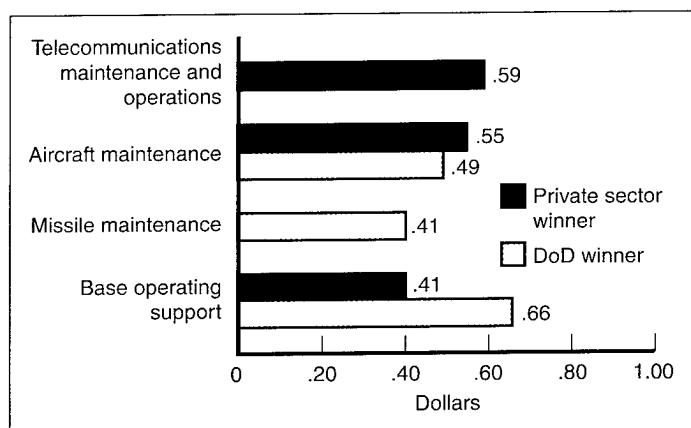
NDRI's FRESH LOOK AT COMPETITIVE SOURCING

At the request of Pentagon personnel managers, RAND took a fresh look at competitive sourcing. It examined six A-76 efforts—two involving base operating support, one involving missile maintenance, two involving aircraft maintenance, and one involving telecommunications maintenance and operations—that took place between 1989 and 1996. Three of these efforts resulted in Air Force, Army, or Navy employee teams winning the opportunity to provide services; private-sector service providers won the other three.

RAND analyzed each effort using a case study approach, reviewing relevant documents and conducting semistructured interviews with DoD and private sector employees to gauge the nature, magnitude, and duration of competitive sourcing's impact on personnel. Because these case studies relied on a relatively small number of sites and employed data that never before had been used for these purposes, RAND's conclusions may not be readily generalizable to other DoD operations.

COMPETITIVE SOURCING GENERATED PERSONNEL COST SAVINGS

As the figure shows, winners of competitive sourcing projected in every instance that they could operate with



*Projected Post-Competitive Sourcing Personnel Costs
(Pre-Competitive Costs = \$1)*

lower personnel costs. For every personnel dollar DoD spent to obtain a given level of service before competitive sourcing, winning bidders promised to provide the same level of service for only 41 cents to 66 cents.

This range of projected personnel cost savings was roughly similar for both private-sector and DoD winners of the A-76 competitive sourcing efforts.

COST SAVINGS CAME FROM REDUCING PERSONNEL

Winning bidders were able to implement the personnel cost savings that they had projected during the competitive sourcing process. To achieve these savings, every private-sector and DoD winner of competitive sourcing reduced its workforce, sometimes significantly. Compared with their pre-competitive sourcing personnel counts, winners of A-76 efforts were able to provide a specified level of services after competitive sourcing with workforces that were some 25 percent to 60 percent smaller.

Many of these workforce reductions came from replacing uniformed military personnel with civilian workers. This substitution allowed A-76 winners to flatten their organizations, operate with fewer managers, and create more-efficient operations, relying on fulltime workers rather than on personnel who at any moment could be called away to other military assignments.

Significantly, only one winner of competitive sourcing slashed wages and benefits to shave personnel costs. Workers at five of the six A-76 winners who held the same positions after competitive sourcing saw no reductions in their paychecks or benefits.

However, most—but not all—of the competitive sourcing winners took a step that had a similar effect: they downgraded positions. Changing the classification structure of their workforces allowed them to reduce the average grade level of workers and pay lower wages.

PERSONNEL COSTS SAVINGS APPEAR TO BE REAL AND ENDURING

Personnel cost savings generated by competitive sourcing appear to be real and long-lasting. At the time RAND analyzed the competitive sourcing winners, their cost savings measures had been in place one to ten years. Each achieved the personnel cost reductions that had been touted during the A-76 competitive bidding process. And each has been able to maintain those savings, with only minor fluctuations, in the years since.

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CONCLUSIONS

The A-76 competitive sourcing process appears to be a potential source of significant personnel cost savings for DoD. It forces DoD managers who are involved in competitive bidding to focus on ways to deliver services more efficiently and effectively. By bringing internal and external suppliers into competition to provide services, competitive sourcing promotes change; it does not allow DoD managers to stay the course.

Whether DoD can stimulate efficiencies and cost savings using other procedures remains an open question. DoD maintains an incentive structure that, by failing to reward managers for reducing personnel costs, discourages them from taking efficiency-enhancing steps and promotes the status quo.

RAND research briefs summarize research that has been more fully documented elsewhere. This research brief describes work done for the National Defense Research Institute; it is documented in Personnel Savings in Competitively Sourced DoD Activities: Are They Real? Will They Last? by Susan M. Gates and Albert A. Robbert, MR-1117-OSD, 2000, 134 pp., \$15.00, ISBN: 0-8330-2826-X, available from RAND Distribution Services (Telephone: toll free, 877-584-8642; FAX: 310-451-6915; or Internet: order@rand.org). Abstracts of all RAND documents may be viewed on the World Wide Web (<http://www.rand.org>). Publications are distributed to the trade by NBN. RAND is a nonprofit institution that helps improve policy and decisionmaking through research and analysis. RAND's publications do not necessarily reflect the opinions of its research sponsors. RAND® is a registered trademark.

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